

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

BIG RIVERS ELECTRIC CORPORATION)	
APPLICATION FOR APPROVAL OF)	
CONTRACT AMENDMENTS WITH THE CITY)	CASE NO. 94-032
OF HENDERSON AND CITY OF HENDERSON,)	
UTILITY COMMISSION AND TO FILE PLAN)	
FOR COMPLIANCE WITH CLEAN AIR ACT)	
AND ENVIRONMENTAL SURCHARGE)	

O R D E R

Big Rivers Electric Corporation ("Big Rivers") has applied for Commission approval of certain amendments to its existing contracts with the City of Henderson ("Henderson") and Henderson Municipal Light and Power ("HMP&L") concerning the use and operation of the Station Two Generating Plant and Big Rivers' purchase of the plant's surplus capacity. Having reviewed the proposed amendments and considered the parties' arguments, we find the proposed amendments to be reasonable and grant our approval.

Henderson, through HMP&L, operates two electric generating stations and an electric distribution system which provides service to the residents of Henderson, Kentucky. In 1970 Big Rivers, Henderson, and HMP&L entered a series of agreements¹ for the

¹ Big Rivers and Henderson entered three agreements: Power Sales Contract, Power Plant Construction and Operation Agreement and Joint Facilities Agreement. The Commission has approved these agreements. See Case No. 5406, Application of the City of Henderson, Kentucky, and City of Henderson Utility Commission for a Certificate of Convenience and Necessity for the Purpose of Constructing Additional Generating Facilities and Related Transmission Facilities as an Extension and Permanent Improvement of its Municipal Light and Power System, and, Application For Approval of Power Plant Construction and Generation Agreement, Joint Facilities Agreement and Power Sales Contract Between City of Henderson, Kentucky and City of Henderson Utility Commission, and Big Rivers Rural Electric Co-operative Corporation (Oct. 22, 1970).

construction and operation of Station Two and the sale of Station Two's excess capacity. Under the terms of these agreements, Henderson financed Station Two's construction with the issuance of municipal bonds and Big Rivers oversaw the plant's construction. Big Rivers operates Station Two and purchases its excess capacity. The Agreements allocate Station Two's fixed costs and operating expenses between the two utilities based upon their annual share of plant capacity. Each utility is responsible for procuring the coal necessary to produce the energy related to its assigned generating capacity.

Station Two has been designated under the Clean Air Act Amendments of 1990 ("CAAA")² as a Phase I compliance facility and required to reduce significantly its sulfur dioxide emissions by 1995. To comply with the CAAA, Henderson, HMP&L, and Big Rivers decided to install flue-gas desulfurization equipment ("scrubbers") at the Station Two Plant. On May 1, 1993, they executed a series of amendments to their earlier agreements to implement this decision.

On February 28, 1994, Big Rivers applied for Commission approval of the contract amendments and its plan to comply with the CAAA and for authority to assess an environmental surcharge to recover its costs of complying with environmental laws. On August 31, 1994, the Commission found Big Rivers' compliance plan reasonable, approved it, and authorized an environmental surcharge mechanism. A ruling on the amendments was deferred.

² Pub. L. No. 101-549 (1990).

Big Rivers, Henderson, and HMP&L argue that the proposed amendments are needed to facilitate the installation and continued operation of the scrubbers. Henderson and HMP&L note that the cost allocation formula in the present agreements is inadequate to ensure a proper allocation of scrubber operating expenses. The cost of sulfur dioxide removal varies with the quality and sulfur content of each utility's coal supply regardless of its BTU content. The present cost allocation formula makes no provisions for this fact.

They further argue that the existing agreements must be modified to identify accurately new joint usage facilities involved in the scrubbers' operation. To that end, the proposed amendments list in detail the joint usage facilities and identify their owner.

Big Rivers argues that the proposed amendments provide major benefits to its ratepayers. They permit Big Rivers to achieve compliance with the CAAA at the lowest cost, grant Big Rivers the option of extending its right to receive power from Station Two for the life of that plant, and allow for the sale of emission allowances which resulted in a \$15.5 million gain.

Urging rejection of the proposed amendments, Kentucky Industrial Utility Customers ("KIUC") contends that the amendments' default provisions place Big Rivers at a significant disadvantage. It contends that, in the event of default, Big Rivers will automatically lose access to Station Two and allow Henderson access to Big Rivers' transmission system to sell Station Two power. This provision, KIUC argues, gives Henderson a competitive advantage

over Big Rivers in wholesale power transactions. KIUC also opposes the proposed amendments because, in its opinion, they provide the Rural Electrification Administration' with additional default remedies.

KIUC's principal objection is to the amendments' allocation of the scrubbers' capital costs based on current capacity usage. KIUC argues that this allocation does not accurately reflect projected usage. If HMP&L's usage continues as projected, KIUC contends, Big Rivers will bear a greater share of capital costs than its share of plant capacity. It refers to an R.W. Beck Study which concluded that, over Station Two's remaining useful life, Big Rivers would only receive 75.9 percent of Station Two's "sendout capacity."

KIUC also contends that Big Rivers receives no consideration for the proposed amendments. It argues that the option to extend the contract over Station Two's remaining useful life has no value. If Big Rivers exercises this option, KIUC argues, it must also pay a portion of Station Two's decommissioning costs. While Station Two's useful life is expected to end in 2019, the useful life of its scrubbers will end in 2015. Additional costs, therefore, may be incurred to keep Station Two operational during those final four years.

After carefully reviewing the proposed amendments, the Commission finds that the installation of the scrubbers requires modification of the existing agreements. The proposed amendments

¹ Since this matter was heard, the Rural Electrification Administration has been renamed "Rural Utilities Service."

contain little to disturb the status quo. Many of the changes are housekeeping in nature. They clarify provisions of the existing agreements or ratify longstanding practices. For brevity's sake, a comparison of the existing agreements and the proposed amendments is set forth in Table 1.

The Commission's analysis of the proposed amendments does not support KIUC's contention that the amendments improve Henderson or HMP&L's position in the event of default. While they list in greater detail Henderson's remedies, most of these remedies are presently available under existing law. Moreover, Big Rivers received some limitations on Henderson's and HMP&L's remedies.

As to the allocation of scrubber costs, financing the project through the sale of allowances significantly affected the parties' approach to the method of allocation. The proposed amendments allocate 82.86 percent of the proceeds from emission allowance sales to Big Rivers and 17.14 percent to Henderson. These proportions are the same as the allocation of Station Two capacity at the time of the amendments' execution. Scrubber costs, up to an amount equal to the proceeds from the sale of allowances, are allocated in the same proportion. Scrubber costs in excess of the amount of the allowance sale proceeds are to be allocated in accordance with the capacity allocation provisions contained in the amendments.

KIUC's contention that the allocation of scrubber capital costs should be based on projected usage rather than current capacity ratios is not persuasive. The R.W. Beck Study upon which

KIUC relies projects energy use, not capacity use. In approving surcharge mechanisms for Big Rivers and Kentucky Utilities Company, the Commission declined to allocate capital costs on the basis of energy use for reasons previously set forth.⁴

KIUC focuses on the allocation of scrubber costs and ignores the allocation of the allowance sale proceeds. Given the scrubber project's reliance on the allowance sale as a financing mechanism, the allocation schemes should be consistent. So long as both parties receive allowance sale proceeds in equal proportion to their respective shares of scrubber costs, neither party is harmed since such treatment of the subject costs and proceeds achieves a result that is basically neutral.

Using current capacity ratios to allocate the scrubber's capital costs is consistent with other provisions of the amendments. For example, the allocation of joint-use facilities at Big Rivers' Green Station to Henderson is based on those facilities' current net book value as of December 31, 1994. With depreciation accruals, the net book value will decrease on an annual basis. However, the parties chose to use the current amount as the basis for allocation even though calculating future changes in the net book value could have easily been done. In this

⁴ Case No. 94-032, Big Rivers Electric Corporation Application For Approval Of Contract Amendments With The City Of Henderson And City Of Henderson Utility Commission And To File Plan For Compliance With Clean Air Act And Environmental Surcharge (Aug. 31, 1994) at 23; Case No. 93-465, The Application Of Kentucky Utilities Company To Assess A Surcharge Under KRS 278.183 To Recover Costs Of Compliance With Environmental Requirements For Coal Combustion Wastes And By-Products, (July 19, 1994) at 20-22.

instance, continued use of the current book value (while the actual book value is decreasing) benefits Big Rivers at Henderson's expense.

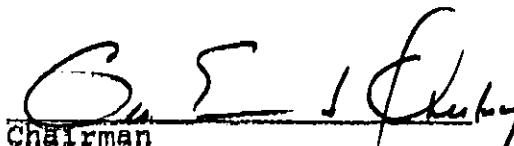
Moreover, the proposed amendments do not weaken the protections contained in the existing agreements. Henderson and HMP&L must provide five years advance notice of any change in the surplus capacity allotted to Big Rivers. No change may exceed 5 MW in any one year. Dramatic shifts in the capacity usage are not likely to occur during the period in which the scrubbers' costs are recovered. If such shifts are necessitated by changes in HMP&L's capacity requirements, the Commission expects the parties to reflect these shifts by further amendments to the present agreements.

The Commission finds that the proposed amendments adequately balance the competing interests of the utilities, are reasonable, and should be approved.

IT IS THEREFORE ORDERED that the proposed amendments are approved.

Done at Frankfort, Kentucky, this 31st day of March, 1995.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman

ATTEST:


Executive Director


Commissioner

**TABLE 1 TO THE COMMISSION'S ORDER IN CASE NO. 94-032
DATED MARCH 31, 1995**

PROVISION	EXISTING AGREEMENTS	PROPOSED AMENDMENTS
CONTRACT TERM	Agreement terminates October 31, 2003. BREC has the option of extending Agreement for two successive five year terms. BREC must give five years advance written notice of extension.	<ul style="list-style-type: none"> o BREC may extend the agreement for the operating life of Station Two. The option must be exercised by October 31, 1998. o BREC may extend the agreement for two successive five year terms. Written notice must be given five years in advance. o If BREC exercises option to extend agreement for the operating life of Station Two, it must bear a proportionate share of Station Two's decommissioning costs based on its shared capacity costs during Station Two's life.
CONTRACT YEAR	Calendar year	Contract year runs from June 1 to May 31. Conforms with Henderson's fiscal year.
DESCRIPTION OF STATION TWO	Identifies Station Two's capacity as 350 MW.	Station Two's new send out capacity is 315 MW. Description includes the SO ₂ scrubbers and new joint use facilities (including BREC facilities which are currently used solely for BREC's Green Station).
SUBMISSION OF CAPACITY COSTS	A detailed statement of the actual capacity costs for Station Two based upon actual audit must be submitted to BREC within 120 days after the end of the contract year.	BREC must submit to Henderson a detailed statement as quickly as possible but no later than 120 days after the end of the contract year.
PAYMENTS ASSOCIATED WITH THE ORIGINAL CONSTRUCTION OF STATION TWO	<p>BREC must make additional payments to Henderson in consideration of the allocation of Station Two surplus capacity. (Approximately \$100,000 per year).</p> <p>Henderson must pay BREC 14.5 cents per month per KWH of Station Two's total capacity.</p>	Such payments will terminate on October 31, 2003.
ALLOCATION OF PROCEEDS OF ANY SO₂ ALLOWANCE SALES	None	17.14% to Henderson; 82.86% to BREC. Allowance sales must be approved by both parties.

PROVISION	EXISTING AGREEMENTS	PROPOSED AMENDMENTS
<p>COST OF JOINT USE FACILITIES</p>	<p>Joint usage costs allocated on the basis of send out capacity.</p>	<p>Allocates the cost which Henderson must pay for the use of BREC's Green Station facilities for Station Two SO₂ Scrubbers based on the facilities' December 31, 1994 net book value. O&M costs for joint use facilities will be based upon <u>actual</u> cost and usage.</p>
<p>REMEDIES IN THE EVENT OF DEFAULT</p>	<p>Parties agree to submit any controversy or claim arising out of contract to arbitration. In the event of default, "the aggrieved party or parties shall, in addition to the remedies specified in this Agreement, have the right to use and employ all remedies available through courts of law and/or equity, governmental agencies and/or regulatory bodies having jurisdiction thereof."</p>	<p>Additional remedies are specified:</p> <ul style="list-style-type: none"> o BREC default under its Restructuring Agreement is considered a default under the Proposed Amendments. o If BREC defaults, Henderson may make sales to others. (Proceeds of such sales will be applied against BREC's capacity charges.) o Upon 30 days written notice of default and BREC's failure to cure, Henderson may terminate agreement and assume immediate possession and operation of Station Two. o Henderson has right to use BREC transmission system to transmit power for off-system sales. Charge for wheeling power will be the fair market value in Kentucky-Indiana area. o In the event of BREC default, Henderson may continue to use joint use facilities. o In the event of default and Henderson's assumption of plant, Henderson may not replace sales being made by BREC or BREC distribution cooperatives. Henderson may not make any sale which adversely affects the rights/interests of BREC' creditors. o If Henderson defaults and all original Station Two Bonds have been paid, BREC may terminate all contracts with Henderson and may continue to use Joint Use facilities.

PROVISION	EXISTING AGREEMENTS	PROPOSED AMENDMENTS
<p>ALLOCATION OF STATION TWO CAPACITY</p>	<p>Henderson has right to Station Two's total capacity. Such capacity shall be used only to serve inhabitants of Henderson and those non-inhabitants which Henderson had contract to serve as of August 1, 1970. BREC has right and obligation to purchase all surplus capacity. Such capacity to be allotted on basis of five years written notice to BREC. Henderson may not resell electricity to others absent special circumstances. Henderson further agrees not to add industrial customers in excess of 10 MW if such addition would require the withdrawal of additional capacity from Station Two.</p>	<p>Parties recognize that current total capacity of Station Two is 315 MW and may be reduced by the addition of SO₂ Scrubbers. Limits adjustments to Henderson's capacity share to 5 MW in any one contract year. Henderson must still provide five years advance written notice. Requires testing of Station Two's total sendout capacity before plant is placed into operation. Provides procedure for testing Station Two's total sendout capacity once the plant is operational. Until the cost of constructing the scrubbers equals the proceeds of the allowance sales, BREC must pay 82.86% of scrubber costs; thereafter cost of the scrubbers shall be apportioned in accordance with capacity allocation.</p>